



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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| Date Introduced: | 02/13/02 | Bill No: | SB 1400 |
| Tax: | Sales and Use | Author: | Romero |
| Board Position: | | Related Bills: | AB 1392 (1999-00) AB 2678 (1997-98) |

BILL SUMMARY

This bill would, among other things, allow a taxpayer to post a bond, instead of paying the tax liability in full, prior to filing an action in a court of law, as specified.

ANALYSIS

Current Law

Under existing law, Section 6481, et seq., of the Sales and Use Tax Law provides that if the Board is not satisfied with the amounts paid on a return or returns or other amounts required to be paid, the Board is required to issue to the taxpayer a written notice of its determination within the three year statute of limitations. Under Section 6561, any person against whom a determination is made may petition for a redetermination within 30 days after service of the notice. If a petition *is not* filed within the 30-day period, the determination becomes final and the Board pursues collection of amounts due. If a petition *is* filed within the 30-day period, Section 6562 provides that the Board shall reconsider the determination and, if the person has so requested, shall grant the person an oral hearing. Under Section 6564, the order or decision of the Board upon a petition becomes final 30 days after it is served upon the petitioner. All determinations issued by the Board are due and payable to the Board at the time they become final. If they are not paid when due and payable, a penalty of 10 percent is applied on the unpaid tax amount.

Generally, a Board hearing is the last step in the administrative appeals process. In the event of a final adverse Board decision, the taxpayer must *pay the tax in full* before filing a suit for refund in superior court. Under Section 6931, no injunction or writ of mandate or other legal or equitable process shall issue in any suit, action, or proceeding in any court against the state to prevent or enjoin the collection of sales and use taxes required to be collected. Further, Article XIII, Section 32 of the California Constitution provides, with regard to collection proceedings, that:

No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

In addition, Section 6932 provides that no suit for refund or proceeding can be maintained in any court unless a claim for refund has been filed. A claim for refund based on issues already heard during the petition process and denied by the Board is not eligible for further hearing. Consequently, in such cases, the Board is required pursuant to Section 6906 to serve notice of its denial of the claim for refund within 30 days of its denial.

Once a claim for refund is denied, Section 6933 requires that any court action must be filed within 90 days after the date the denial notice is mailed.

Proposed Law

This bill would, among other things, amend Section 6931 of, and add Section 6931.5 to, the Sales and Use Tax Law to allow for an action to determine the validity of an amount of tax or any other amount assessed by the Board to be brought against the Board in a court of law if the taxpayer, within one year after the assessment becomes final, posts a bond guaranteeing payment of the amount due or the amount reasonably expected to become due during the first year of the action.

The bill would further provide that, if a taxpayer files a bond in accordance with the provisions of the bill, no late payment penalty may be assessed. Additionally, the bill would require that the bond be approved and accepted by the judge of the trial court hearing the action, and if approved and accepted, no further collection of any assessed amount that is the subject of the action shall be made during the pendency of the action. However, the bill would require the Board, not more than once a year during the pendency of that action, to require the taxpayer to either increase the amount of the bond to guarantee the additional interest that accrued during the year or to pay the additional interest.

The bill would specify that the liability on the bond may be enforced by the trial court if the assessment is determined to be valid and is not paid within 30 days after the judgment on the action becomes final.

In addition, the bill would incorporate similar provisions under the California Personal Income Tax and the Bank and Corporations Tax laws administered by the Franchise Tax Board.

The bill would become effective January 1, 2003.

Background

Similar bills have been considered in the past. During the 1999-2000 Legislative Session, AB 1392 (Hertzberg) was held in the Senate Appropriations Committee, and in the 1997-98 session, AB 2678 (Pringle) failed passage in the Assembly Revenue and Taxation Committee. The Board voted to support both AB 1392 and AB 2678.

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COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the California Manufacturers and Technology Association and is intended to provide taxpayers with an equitable remedy to proceed to court without having to pay the entire tax liability.
2. **Current law widely recognizes the policy to protect the collection processes and to prevent unnecessary interruption of governmental services that are dependent on revenue.** Under the State Constitution, the only legal avenue to resolve a tax dispute is to pay the tax and then contest it as appropriate, with the state to pay interest on any taxes wrongfully collected (*State Board of Equalization v. Superior Court*, (1985) 39 Cal.3d 633). California Constitution Section 32, sometimes called the anti-injunction provision, prohibits taxpayers from using legal or equitable procedures, such as declaratory judgments or injunctions, to restrain or inhibit the assessment or collection of taxes. This provision has been broadly construed to bar not only injunctions, but also a variety of prepayment judicial declarations or findings that would impede the prompt collection of a tax. The section incorporates a widely recognized policy allowing revenue collection to continue during litigation, in order to protect the collection processes and to prevent unnecessary interruption of governmental services dependent on revenue (*Pacific Gas and Electric Co., v. State Board of Equalization*, (1980) 27 Cal.3d 277). That decision noted that “the fear that persistent interference with the collection of public revenues, for whatever reason, will destroy the effectiveness of government has been expressed in many judicial opinions.” Similar prohibitions are found in the Revenue and Taxation Code for the various taxes and fees administered by the Board. Those statutes express an important public policy that exceptions to the policy should not be implied but should only be recognized where the Legislature has clearly expressed its recognition.

One area of the law in which the Legislature has made an exception is contained in Revenue and Taxation Code Section 19081, which authorizes a taxpayer who claims to be a nonresident for purposes of payment of personal income taxes to litigate that one fact and allows for the postponement of the collection of the disputed tax until completion of the litigation. In the case of *Franchise Tax Board v. Superior Court* (1989) 212 Cal.app.3d 1343 the Franchise Tax Board contended that Section 19081 violated Article XIII, Section 32 of the California Constitution. The court found that Section 19081, which allows litigation of residency cases without prepayment of the tax, did not violate the Constitution. And, the Legislative Counsel has also opined that, although the decision deals with a residency issue and not the question of the amount of tax due, the court’s decision provides justification for the Legislature to allow taxpayers to challenge their tax assessments without requiring them to pay the tax first.

Enactment of this measure would clearly demonstrate the Legislature’s recognition that it has authorized and consented to the postponement of collection of the taxes pending resolution of litigation in cases where a sufficient bond is posted.

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3. **Bill would provide an avenue for taxpayers to obtain judicial review without having to make a cash payment.** Since the cost of posting a bond would generally be significantly less than making a cash payment, enactment of this bill would provide an equitable remedy by enabling the taxpayer to retain access to the use of the money backing the bond while the taxpayer carries out his or her challenge to the assessment in court.
4. **The posting of a bond would not prevent accrual of interest on the unpaid tax amount.** Interest on underpayments of tax is calculated based on specified provisions of the Internal Revenue Code, plus three percentage points. This rate is currently set at 10 percent. The posting of a bond would not stop the accrual of interest. Typically, resolution of disputed taxes in litigation takes eight years to resolve.

COST ESTIMATE

While there could be a decrease in costs attributable to fewer cases being reviewed at the administrative level, there would be an offsetting increase in costs attributable to the workload increase for litigated cases.

REVENUE ESTIMATE

It is difficult to determine with any accuracy what effect, if any, enactment of this measure would have on the state's revenues. The posting of a bond could detrimentally affect cash flow, but would not appear to impact revenues. In cases where a taxpayer posted a bond and prevailed in the litigation, there could be some credit interest savings for the period of time that the case was under litigation (currently, when a taxpayer prevails in litigation, the tax is paid in full, and Section 6936 requires that credit interest be paid on the amount starting from the date the amount was paid to the date the refund is initiated by the Board).

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